



THE COMMONWEALTH OF MASSACHUSETTS  
OFFICE OF THE ATTORNEY GENERAL

200 PORTLAND STREET  
BOSTON, MASSACHUSETTS 02114

TOM REILLY  
ATTORNEY GENERAL

(617) 727-2200  
<http://www.ago.state.ma.us>

SENT ELECTRONICALLY, BY FAX AND MAIL

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Mary L. Cottrell, Secretary  
Department of Telecommunications and Energy  
One South Station, 2<sup>nd</sup> Floor  
Boston, Massachusetts 02110

**Re: Default Service, D.T.E. 02-40**

Dear Secretary Cottrell:

On June 21, 2002, the Department of Telecommunications and Energy ("Department") opened an Investigation into the Provision of Default Service ("Default Service NOI"), which was docketed as D.T.E. 02-40. The Department will investigate all aspects of the manner in which Default Service is provided to ensure that it is compatible with the development of an efficient market. Order at 1. The Department specifically stated that it will reconsider some issues it had decided in prior proceedings, and evaluate its Default Service policies in terms of (1) the price components to be included in Default Service rates, including administrative and bad debt costs and the effects of locational marginal pricing; (2) Default Service pricing options; and (3) schedules and strategies. The Department stated that it will also look at the role of the distribution company in moving their customers toward competitive supply and whether distribution companies should serve as the "providers of last resort" or whether other entities can and should provide this function.

Pursuant to the Department's June 21, 2002 notice, the Attorney General submits this letter as his Comments on modifications to Default Service.

I. INTRODUCTION

Electric service is an essential service and should be available and affordable to all customers. *Electric Restructuring*, D.P.U. 95-30, p. 16 (1995). In the new electric industry,

each distribution company must continue to have an obligation to provide a basic service to all customers in its service territory (1) who choose not to contract directly for electricity with a supplier; (2) who cannot obtain power in the open market or (3) whose supplier fails to provide generation service. *Electric Restructuring*, D.P. U. 96-100, p. 45 (1996).

In light of recent problems with energy marketing and trading firms, we urge the Department to proceed with extreme caution as it considers any changes for Default Service customers. The Department should reject attempts to throw default customers to the mercies of a market with nascent competition that may not be fully effective in disciplining market power and monopoly/oligopoly pricing.

## **II. STATUTORY FRAMEWORK REQUIRES THAT DEFAULT SERVICE BE PROVIDED ON REASONABLE TERMS**

The General Court has determined that “electricity service is essential to the health and well-being of all residents of the commonwealth, to public safety, and to orderly and sustainable economic development,” and that “affordable electric service should be available to all consumers on reasonable terms and conditions.” *Electric Utility Restructuring Act of 1997* (“Act”) St. 164, c. 1997, section 1. The Legislature recognized that the transition from a monopoly-regulated electricity market to a competitive market structure would take time and would require a service of last resort or Default Service for those customers who, for whatever reason, were unable to secure standard offer service or competitive service in the restructured market. The Legislature intended the service of last resort, or Default Service, as a means of ensuring that all customers in Massachusetts have universal access to electricity.<sup>1</sup>

In *Default Service*, D.T.E. 99-60-A, p. 5 (2000), the Department stated that Default Service is intended to be a basic service that provides customers with the appropriate incentives to turn to the competitive market for more sophisticated or advantageous service offerings. The Department has relied on four guiding principles: (1) Default Service prices should be market based, be procured through reasonable business practices, and take into account the costs of providing Default Service, consistent with the development of robust competitive retail markets; (2) costs associated with providing Default Service should be minimized; (3) customer confusion should be minimized; and (4) a general consistency in Default Service across distribution service territories should be achieved, to the extent that consistency is feasible and would provide benefits to ratepayers. D.T.E. 99-60-A, p. 6.

Since we are currently half-way through the transition period from a regulated market to a competitive one, we have the opportunity to evaluate Default Service or service of last resort, and determine how, if at all, to change Default Service after the standard offer period ends. The Department, however, should not lose sight of the Legislature’s mandate that Default Service be provided to consumers “on reasonable terms and conditions.”

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<sup>1</sup> General Laws Chapter 164, Section 1B(d)[4] requires that: (1) each distribution company provide Default Service; (2) the Default Service be competitively procured; (3) the Default Service rate “shall not exceed the average monthly market price of electricity;” and (4) bids to supply Default Service “shall include payment options with rates that remain uniform for periods of up to six months.” See *Default Service*, D.T.E. 99-60-A, pp. 3-4 (2000).

### III. THE DEPARTMENT SHOULD AVOID MAJOR CHANGES IN DEFAULT SERVICE

The wholesale market upon which retail electric service depends continues to experience major structural changes. Since the enactment of the 1997 Restructuring Act, the Federal Energy Regulatory Commission (“FERC”) has undertaken a series of steps to change the wholesale electric markets, including the proposed creation of Regional Transmission Organizations; a proposed Northeast Regional Transmission Organization arising from a merger of the New York and New England Independent System Operators; the implementation of locational marginal pricing, designed to send more accurate price signals to constrained areas on the Transmission system; the elimination of “seams” issues through Standard Market Design; and the creation of day ahead markets.<sup>2</sup> If implemented, each of these FERC proposals to change the wholesale markets will have an effect on retail markets and on Default Service procurement and pricing. The Department, therefore, should proceed cautiously as it considers changes to the current pricing and procurement design of service of last resort since those issues remain unresolved.<sup>3</sup> The wholesale markets are still in transition and must be operating successfully under a set of stable rules and procedures before the Department makes any significant changes in retail Default Service programs. *See Gas Unbundling*, D.T.E. 98-32-B, pp. 26-27 (1999)(adopting mandatory capacity assignment in capacity constrained areas where the market is not workably competitive.)

### IV. EVALUATION OF PROPOSALS

During the course of this proceeding the Department will receive different proposals about how to “reform” Default Service now, in advance of the end of standard offer service. The Department should evaluate these proposals according to a set of principles that ensures that the cost to provide Default Service is minimized, the process does not result in customer

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<sup>2</sup> In its recently issued Standard Market Design Notice of Proposed Rulemaking (“NOPR”), FERC clearly and unequivocally states that the transition to competitive electricity markets has not fulfilled the promise to provide more customer choice and lower average electric rates. FERC notes that the California electricity crisis, the collapse of Enron, the allegations of improper trading practices, and the financial deterioration of many energy suppliers and marketers has “added unprecedented uncertainty about, and lack of confidence in, today’s electric markets. *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design*, Docket No. RM01-12-000, pp. 57-58 (July 31, 2002). FERC’s plan to remedy this situation is to make sweeping changes in the wholesale market “. . . to resolve generically many of the uncertainties facing the electric power industry and to restore confidence in future power markets.” *Id.*, p. 59.

<sup>3</sup> Significant questions have arisen regarding whether wholesale congestion costs in the Northeastern Massachusetts Area (“NEMA”) are the result of market power and thus are not just and reasonable. *See NSTAR Electric & Gas Corporation v. Sithe and PG&E Energy Trading*, FERC Docket No. EL01-79-000. Default Service should be designed in such a way that it does not exacerbate market power.

confusion, and the procurement process provides a level of price stability to customers without alternatives. Default Service procurement procedures and policies also should be structured to diminish the potential for wholesale market abuses.<sup>4</sup>

The Legislature envisioned Default Service not as a competitive product, but as one that will be available to customers, who, for whatever reason, do not have a competitive supplier or who are ineligible to receive standard offer service. After the transition period, Default Service will still be available to such customers. Consistent with the Act, Default Service or service of last resort should be a stable and reasonably priced product for all customer classes. Procurement should be designed to best serve the interests of customers, not suppliers. Default Service should be a “plain vanilla” service and not attempt to be all things to all participants. We should not try to achieve competition by raising rates for Default Service to assist competitive suppliers’ entry into the marketplace. *See Gas Unbundling*, D.T.E. 98-32-B, p. 25 (1999)

Moreover, service of last resort should be reliable and should not result in any degradation of service quality or the protections afforded by consumer protection statutes and regulations. *See* G.L. c. 164 § 1F. Therefore, the Department should not allow a distribution company to assign a customer without prior consent, consistent with the Act’s anti-slamming provisions and the Department’s regulations. *See* G.L. c. 164 § 1F (8)(a)(i) (“It shall be unlawful for a generation company, supplier or aggregator to provide power or other services to such a customer without first obtaining said affirmative choice from the customer.”); *see also* 220 CMR §11.05. Customers should not be assigned without their prior consent, even if the assignment is a “virtual” assignment.<sup>5</sup>

The focus of any new inquiry on Default Service should be whether customers will benefit rather than whether competitive suppliers or the competitive market will benefit. DOER’s customer migration data shows that, to date, only a small minority of residential and small-medium sized commercial and industrial customers participate in the competitive market.<sup>6</sup> The Department anticipated the likelihood of this outcome during the Massachusetts

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<sup>4</sup> Such principles and proper structures are particularly important given current and emerging concerns about the business practices of energy marketing and trading firms—some of whom are licensed to do business in Massachusetts. “[T]he function of the department is the protection of public interests and not the promotion of private interests.” *Lowell Gas Light Company v. Department of Public Utilities*, 319 Mass. 46, 52, (1946). *See Massachusetts Institute of Technology v. Department of Public Utilities*, 425 Mass. 856, 873 fn. 38 (1997).

<sup>5</sup> It is an unfair or deceptive act or practice under the provisions of G.L. c. 93A for a retail seller of electricity to “replace or arrange to replace a consumer's current provider of electricity service with its own service or with the service of any other retail seller of electricity, without the consumer's express, affirmative consent, . . . “ 940 CMR 19.06 (d).

<sup>6</sup> As of May 2002, the DOER customer migration data shows that the total number of residential  
(continued...)

Electric Company Restructuring settlement. *Massachusetts Electric Company*, D.P.U. 96-25, pp.35-36. It is reasonable to conclude that the market balance at the end of the transition period will be similar to the balance that exists today, with large C&I customers as the primary market participants and little significant residential or small- medium-sized C&I interest in the competitive market. The service provided at the expiration of the transition period, although a service of last resort, will, in all likelihood, be the primary service for the majority of customers. The service of last resort should not be viewed as a competitive “product,” but rather as an extension of the service that exists today.

Several different approaches to the future design of the Default Service programs in Massachusetts will be presented to the Department in the requested comments. The Attorney General joins NSTAR and the Massachusetts Community Action Program Directors Association (“MASSCAP”) in proposing a set of guiding principals for the Department to use in screening various proposals.

- A. The overall objective of restructuring was and remains to produce real benefits for all customers, and all proposals for change must be measured against this standard.
- B. Restructuring and wholesale competition have produced substantial benefits for customers, although opportunities for direct access to retail markets have developed at a different pace for different customer groups.
- C. Smaller customers have not had significant access to competitive retail electric markets; residential, and especially low-income customers, may not have viable, reasonably priced retail competitive options.
- D. Default Service provided by local utilities may be the only viable energy option for small, residential and low-income customers for the foreseeable future; such service provides a valuable means of delivering the benefits of the competitive market to those customers, and should continue to be offered to them.
- E. Default Service prices should not be below the costs incurred to procure Default Service from the competitive market -- this ensures that Default Service rates are not subsidized and thereby create an artificial price barrier to retail competition.
- F. Customers should not be forced to pay rates for Default Service that exceed the

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<sup>6</sup>(...continued)

non-low income competitive customers was 15,079, compared to 1,425,205 standard offer service customers and 610,696 Default Service customers. While the numbers for small (11,811 competitive, 79,385 Default Service and 156,057 standard offer) and medium C&I customers (5,264 competitive, 11,433 default and 31,300 standard offer) are a bit higher than for residential, clearly the highest percentage of competitive customers on a percentage basis is in the large C&I sector (1,820 competitive, 1,274 default, 3,538 standard offer).

market-based, competitively established costs to serve them so that even those customers who do not have viable, direct access to retail competition will continue to benefit from competitive markets.

- G. Retail **choice** should be maintained and therefore customers should not be involuntarily assigned to retail suppliers (i.e., slammed).

## V. RECOMMENDATIONS

The Attorney General, NSTAR and MASSCAP further recommend that the Department should make the following changes to Default Service:

- A. The price of Default Service should include only those costs incurred to provide the service. These costs may include items such as uncollectibles and the administrative costs of procuring energy, provided that an appropriate relationship is maintained between base rates and Default Service rates.<sup>7</sup>
- B. Default Service for large customers should be procured and priced on a short term basis, in order to maintain a close relationship between the price of Default Service and the real time, wholesale price of power.
- C. Default Service for small customers should be procured and priced over a longer term, in order to assure greater price stability for those customers.
- D. The parties do not believe that additional pricing options are needed for customers, since customers currently have the option of variable or fixed (six month) pricing alternatives.
- E. Any mandated procurement process for Default Service should be flexible enough to allow utilities to make purchases that are in the customers' best interests and result in the lowest reasonable price for customers.

By the adoption of these recommendations, the Department will fulfill its obligation to provide reasonably priced universal service to those customers who choose not to contract directly for electricity with a supplier, who cannot obtain power in the open market or whose

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<sup>7</sup> Consistent with the Department's decision in D.T.E. 99-60-A, "identification and calculation of the administrative costs incurred by a distribution company in providing Default Service would appropriately be done in a base rate proceeding." D.T.E. 99-60-A, p. 10.

supplier fails to provide generation service.

Respectfully Submitted,

TOM REILLY  
ATTORNEY GENERAL

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By: Joseph W. Rogers  
Judith Laster  
Assistant Attorneys General